

Message Text

CONFIDENTIAL

PAGE 01 JAKART 02221 01 OF 04 180635Z
ACTION EA-12

INFO OCT-01 ISO-00 SS-15 ONY-00 /028 W
-----088831 180638Z /11

R 171010Z FEB 78
FM AMEMBASSY JAKARTA
TO SECSTATE WASHDC 6911

C O N F I D E N T I A L SECTION 1 OF 4 JAKARTA 2221

STADIS////////////////////////////////////

FOR EA ONLY

E.O. 11652: GDS
TAGS: EFIN, ID
SUBJECT: EXCHANGE RATE AND DEVELOPMENT

REF: STATE 24207

1. SUMMARY: THIS MESSAGE ATTEMPTS TO PROVIDE AN ANALYSIS OF THE VALUE OF THE RUPIAH BOTH FROM AN OVERALL VIEW WHICH EXAMINES THE VALUE OF THE RUPIAH AS IT RELATES TO INDONESIA'S NON-EXTRACTIVE EXPORTS. OUR ATTEMPT IS BY NO MEANS REGARDED AS A DEFINITIVE ANALYSIS AND WE WOULD WELCOME COMMENT AND CRITICISM. IN VIEW OF THE SENSITIVITY OF THE SUBJECT, THE REPORT SHOULD BE CLOSELY HELD. A SUBSEQUENT MESSAGE WHICH SHOULD FOLLOW WITHIN ABOUT A WEEK, WILL ATTEMPT TO EXAMINE SOME OF THE INTERNAL EFFECTS OF THE GOI'S EXCHANGE RATE POLICY. END SUMMARY.

2. INDONESIA'S STRONG EXPORT PERFORMANCE OVER THE PAST TWO YEARS HAS PRODUCED VERY LARGE BALANCE OF PAYMENTS SURPLUSES AND PUSHED FOREIGN EXCHANGE RESERVES TO RECORD LEVELS. NOTWITHSTANDING THIS STRONG PERFORMANCE, HOWEVER, MANY OBSERVERS BELIEVE THAT THE AGGREGATED DATA OF THE BALANCE OF PAYMENTS TABLES CONCEAL SERIOUS
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 JAKART 02221 01 OF 04 180635Z

STRUCTURAL PROBLEMS WITHIN THE INDONESIAN ECONOMY. THEY CONTEND THAT THE CORE OF THE PROBLEM IS AN OVERVALUED RUPIAH WHICH HAS LED TO STAGNATION IN INDONESIA'S TRADITIONAL EXPORT SECTOR AND ITS IMPORT-COMPETING INDUSTRIES WITH A SONSEQUENT LOSS IN EMPLOYMENT OPPORTUNITIES. IN THIS REPORT THE EMBASSY EXAMINES INDONESIA'S EXCHANGE RATE POLICY AND ITS IMPLICATIONS FOR DEVELOPMENT.

3. NO BALANCE OF PAYMENTS CASE FOR DEVALUATION - THE QUADRUPLING OF OIL PRICES IN 1974 WHICH RESULTED IN A DOUBLING OF INDONESIA'S FOREIGN EXCHANGE EARNINGS FROM EXPORTS DRASTICALLY CHANGED INDONESIA'S EXTERNAL FINANCIAL POSITION FROM ONE OF CHRONIC DEFICIENCY OF FOREIGN EXCHANGE TO ONE OF RELATIVE ABUNDANCE. FOR A TIME, THIS CHANGE WAS MASKED BY A GLOBAL RECESSION AND THE PERTAMINA CRISIS BUT IN 1976, DESPITE RECORD IMPORTS, INDONESIA'S EXTERNAL RESERVES GREW BY OVER \$1 BILLION AND THEY CONTINUED TO GROW RAPIDLY THROUGH 1977. IT IS TRUE THAT INDONESIA'S BOP PERFORMANCE WAS ASSISTED VERY MATERIALLY DURING THIS PERIOD BY LARGE INFLOWS OF FOREIGN CAPITAL, LARGELY ODA, AND IT CAN ALSO BE ARGUED THAT THIS SURPLUS CONDITION WILL ALMOST SURELY BE SHORT-LIVED IF, AS MANY BELIEVE LIKELY, OIL EXPORTS SOON START TO DECLINE. FOR PURPOSES OF THE PRESENT DISCUSSION, HOWEVER, IT IS SUFFICIENT TO SAY THAT A CASE CANNOT CURRENTLY BE MADE ON BALANCE OF PAYMENTS GROUNDS THAT THE RUPIAH IS OVERVALUED. QUITE THE CONTRARY, IN FACT, TO THE EXTENT THERE ARE PRESSURES ON THE RUPIAH, THEY ARE UPWARD PRESSURES WHICH, IF LEFT UNTENDED, WOULD PROBABLY RESULT IN AN APPRECIATION OF THE RUPIAH'S VALUE.

4. CURRENT ACCOUNT REMAINS IN DEFICIT - HOWEVER,
CONFIDENTIAL

CONFIDENTIAL

PAGE 03 JAKART 02221 01 OF 04 180635Z

ANALYZING THE BOP ACCOUNTS REVEALS CERTAIN ASPECTS OF INDONESIA'S PERFORMANCE WHICH POSE FUTURE PROBLEMS. NOTWITHSTANDING THE DOUBLING OF EXPORT EARNINGS AS A RESULT OF OIL PRICE INCREASES, INDONESIA CONTINUES TO RUN LARGE CURRENT ACCOUNT DEFICITS. THIS IS LARGELY THE RESULT OF AN EXPANSION OF THE GOI'S DEVELOPMENT PROGRAM AND NOT TO BE CRITICIZED PER SE PROVIDED IMPORTS, WHICH HAVE MORE THAN DOUBLED BETWEEN 1973 AND 1976, ARE DESIGNED TO MAXIMIZE ACHIEVEMENT OF DEVELOPMENT GOALS AND PROVIDED ALSO THAT DEBTS CONTRACTED TO OFFSET THE CURRENT ACCOUNT DEFICITS CAN BE SERVICED WITHOUT UNDULY MORTGAGING THE COUNTRY'S FUTURE. AN INVESTIGATION OF THESE CONSIDERATIONS, HOWEVER, IS TOO FAR AFIELD FOR PURPOSES OF THIS ANALYSIS. OF MORE IMMEDIATE CONCERN, HOWEVER, IS WHAT IS HAPPENING WITHIN THE TRADE ACCOUNT AND SPECIFICALLY WITH REGARD TO THE COMPOSITION OF INDONESIA'S EXPORTS.

NO GROWTH IN NON-EXTRACTIVE EXPORTS

5. IN ANALYZING INDONESIA'S TRADE FIGURES, IT IS CUS-
TOMARY TO DISTINGUISH BETWEEN OIL AND NON-OIL EXPORTS.

FOR THE PURPOSES OF THE PRESENT STUDY WE MAKE A FURTHER REFINEMENT TO DISTINGUISH BETWEEN EXTRACTIVE EXPORTS, WHICH ARE CONSIDERED TO BE PETROLEUM, HARD MINERALS AND UNPROCESSED LUMBER, AND NON-EXTRACTIVE EXPORTS, I.E., ALL ELSE. WE MAKE THIS DISTINCTION BECAUSE EXTRACTIVE ENTERPRISES IN INDONESIA ARE FOR THE MOST PART, LARGE, CAPITAL-INTENSIVE, EXPORT-ORIENTED ENCLAVES WITH VERY LIMITED LINKAGES INTO THE REST OF THE ECONOMY WHEREAS NON-EXTRACTIVE ENTERPRISES TEND TO BE SMALLER-SCALE, HIGHLY COMPETITIVE, MORE LABOR-INTENSIVE, AND INTEGRATED INTO THE ECONOMY.

6. THE U.S. DOLLAR VALUE OF INDONESIA'S TOTAL EXPORTS INCREASED BY NEARLY 600 PERCENT BETWEEN 1971 AND 1976.
CONFIDENTIAL

CONFIDENTIAL

PAGE 04 JAKART 02221 01 OF 04 180635Z

HOWEVER, WITHIN THIS TOTAL, NON-EXTRACTIVE EXPORTS LAGGED FAR BEHIND EXTRACTIVES GROWING ONLY 182 PERCENT AS COMPARED WITH 900 PERCENT FOR EXTRACTIVES. AS A RESULT, THE NON-EXTRACTIVE SHARE OF TOTAL EXPORTS FELL FROM 42 PERCENT IN 1971 TO 14 PERCENT IN 1976. MOREOVER, VIRTUALLY ALL OF THE VALUE INCREASE IN NON-EXTRACTIVES CAME FROM PRICE INCREASES AS VOLUME REMAINED STAGNANT.

CONFIDENTIAL

NNN

CONFIDENTIAL

PAGE 01 JAKART 02221 02 OF 04 180657Z
ACTION EA-12

INFO OCT-01 ISO-00 SS-15 ONY-00 /028 W
-----089025 180659Z /11

R 171010Z FEB 78
FM AMEMBASSY JAKARTA
TO SECSTATE WASHDC 6912

C O N F I D E N T I A L SECTION 2 OF 4 JAKARTA 2221

STADIS FOR EA ONLY//////////

7. SIMILAR STAGNATION HAS NOT OCCURRED IN NEIGHBORING COUNTRIES. IN THAILAND, FOR EXAMPLE, EXPORT VALUE

ROSE 257 PERCENT 1971-76 WHICH INCLUDED A VOLUME INCREASE OF 65 PERCENT. DURING THAT PERIOD, EXTRACTIVE EXPORTS DECLINED FROM 11 TO 6 PERCENT OF TOTAL EXPORTS. IN THE PHILIPPINES, EXPORT VOLUME ROSE 53 PERCENT ALSO DESPITE A DECLINE IN EXTRACTIVE EXPORTS. EXTRACTIVE EXPORTS ALSO DECLINED IN MALAYSIA WHERE VOLUME GREW BY 35 PERCENT.

8. MANY BELIEVE THAT STAGNATION HAS OCCURRED IN INDONESIA'S TRADITIONAL EXPORT INDUSTRIES BECAUSE THE RELATIVELY SMALL, INDIGENOUS PRODUCERS WHO ARE RESPONSIBLE FOR THESE EXPORTS HAVE BEEN CAUGHT IN A SERIOUS COST-PRICE SQUEEZE AS A RESULT OF INFLATION. THESE OBSERVERS MAINTAIN THAT BECAUSE THE INFLATION RATE IN INDONESIA HAS BEEN SUBSTANTIALLY HIGHER THAN ELSEWHERE AND BECAUSE THE RUPIAH HAS BEEN PEGGED TO THE DOLLAR (SHILE MANY OTHER CURRENCIES HAVE FLOATED), THE RUPIAH HAS TENDED TO BECOME SERIOUSLY OVERVALUED.

9. THOSE WHO DEFEND THE CURRENT VALUE OF THE RUPIAH, HOWEVER, ARGUE THAT THE HIGHER RATE OF INFLATION IN INDONESIA HAS TENDED TO BE OFFSET BY THE DEPRECIATION OF THE DOLLAR, AND HENCE THE RUPIAH, VIS-A-VIS OTHER MAJOR TRADING CURRENCIES, THAT INDONESIAN NON-OIL

CONFIDENTIAL

PAGE 02 JAKART 02221 02 OF 04 180657Z

EXPORTS HAVE BEEN MADE MORE COMPETITIVE THROUGH THE REDUCTION OR ELIMINATION OF CERTAIN EXPORT TAXES, AND THAT RISING WORLD PRICES FOR INDONESIA'S TRADITIONAL EXPORTS HAVE OFFSET HIGHER DOMESTIC COSTS. THESE ARGUMENTS WILL BE EXAMINED BELOW.

10. THE EFFECTIVE RATE OF EXCHANGE. IN 1971 THE RUPIAH WAS DEVALUED BY 9 PERCENT AND PEGGED AT 415 RUPIAH TO THE U.S. DOLLAR. HOWEVER, BECAUSE OF EXPORT TAXES, WHICH AVERAGED ABOUT 8 PERCENT, THE EFFECTIVE RATE OF EXCHANGE FOR NON-OIL EXPORTS AMOUNTED TO 382 RP EQUALS US\$1 (I.E., 415 LESS 8 PERCENT). IN 1976, THE GOVERNMENT REDUCED OR ELIMINATED A NUMBER OF THESE TAXES WHICH, ACCORDING TO THE IMF, LOWERED THE AVERAGE EXPORT TAX TO VERY SLIGHTLY LESS THAN 6 PERCENT. THE LOWERING OF THE EXPORT TAX PROVIDED A MODEST IMPROVEMENT IN THE EFFECTIVE EXPORT RATE OF EXCHANGE.

11. IN ADDITION TO THE ENCOURAGEMENT OFFERED EXPORTERS BY THE LOWERING OF THE AVERAGE EXPORT TAX RATE, EXPORTERS ALSO BENEFITED DURING THIS PERIOD AS THE RUPIAH DEPRECIATED IN VALUE ALONG WITH THE U.S. DOLLAR VIS-A-VIS OTHER MAJOR TRADING CURRENCIES. INDONESIA'S LEADING MARKETS FOR NON-EXTRACTIVE EXPORTS IN 1976 WERE:

| COUNTRY | PERCENTAGE |
|---------|------------|
|---------|------------|

| | |
|-------------|------|
| U.S. | 28.7 |
| SINGAPORE | 23.4 |
| JAPAN | 12.1 |
| NETHERLANDS | 9.6 |
| FRG | 9.4 |
| TOTAL | 83.2 |

THE RUPIAH RATE OF EXCHANGE VIS-A-VIS THESE MAJOR TRADING
CONFIDENTIAL

CONFIDENTIAL

PAGE 03 JAKART 02221 02 OF 04 180657Z

CURRENCIES CHANGED AS FOLLOWS BETWEEN 1971 AND
SEPTEMBER 1977. (ALL DATA FROM IMF'S INTERNATIONAL
FINANCIAL STATISTICS (IFS) EXPRESSED IN RUPIAH PER UNIT
OF FOREIGN CURRENCY, EXCEPT JAPAN PER 100 YEN):

| COUNTRY | 1971 | 1977 | PERCENT GAIN |
|---------|------|------|--------------|
|---------|------|------|--------------|

| | | | |
|--------------------------|-----|-----|---|
| U.S.-PUBLISHED RATE (PR) | 415 | 415 | |
| EFFECTIVE RATE (ER) | 382 | 391 | 2 |

| | | | |
|----------------|-----|-----|----|
| SINGAPORE - PR | 138 | 170 | |
| | 127 | 160 | 26 |

| | | | |
|------------|-----|-----|----|
| JAPAN - PR | 122 | 156 | |
| ER | 113 | 147 | 30 |

| | | | |
|------------------|-----|-----|----|
| NETHERLANDS - PR | 121 | 169 | |
| ER | 111 | 159 | 43 |

| | | | |
|----------|-----|-----|----|
| FRG - PR | 122 | 180 | |
| ER | 112 | 170 | 52 |

FROM THE FOREGOING IT IS EVIDENT THAT A SIGNIFICANT DE-
VALUATION OF THE RUPIAH OCCURRED BETWEEN 1971 AND 1977
WITH ALL MAJOR TRADING PARTNERS EXCEPT THE U.S.,
INDONESIA'S TARGETS MARKET FOR NON-EXTRACTIVE EXPORTS.
ON A TRADE WEIGHTED BASIS AMONG THESE FIVE COUNTRIES,
THE RUPIAH DEPRECIATED BY 23 PERCENT, I.E., FOR EACH
UNIT OF FOREIGN EXCHANGE AN EXPORTER EARNED, HE RECEIVED
23 PERCENT MORE RUPIAH.

12. FOR THE EXPORTER, HOWEVER, INCREASED RUPIAH PRO-
CEEDS PER UNIT OF FOREIGN EXCHANGE WILL NOT BY
ITSELF MAINTAIN HIS PROFITABILITY IF HIS DOMESTIC PRO-
DUCTION COSTS RISE FASTER THAN THE RUPIAH
CONFIDENTIAL

CONFIDENTIAL

PAGE 04 JAKART 02221 02 OF 04 180657Z

DEPRECIATES. THIS CONSIDERATION IS EXAMINED BELOW.

PURCHASING POWER PARITY (PPP)

13. THE PURCHASING POWER PARITY CONCEPT IS COMMONLY APPLIED AS A WAY OF MEASURING WHETHER A CURRENCY OVER A PERIOD OF TIME HAS BECOME OVER- OR UNDERVALUED. TAKING THE U.S. AND INDONESIA AS EXAMPLES AND REVIEWING THE PERIOD FROM 1971 (WHEN INDONESIA DEVALUED AND PEGGED THE RUPIAH AT 415 TO THE DOLLAR) TO THE PRESENT, THE PPP THEORY HOLDS THAT SINCE THE DOMESTIC PRICE LEVEL IN INDONESIA HAS RISEN MUCH FASTER THAN IN THE U.S., THE PURCHASING POWER OF THE DOLLAR OVER INDONESIAN GOODS AND SERVICES HAS DECLINED. IN THE ABSENCE OF EQUILIBRATING EXCHANGE RATE ADJUSTMENTS, AND ASSUMING OTHER FACTORS CONSTANT, THE REDUCED PURCHASING POWER AND THE RELATIVELY HIGHER PURCHASING POWER OF THE RUPIAH INCREASES DEMAND FOR U.S. GOODS. LOOKING AT THE SITUATION FROM THE INDONESIAN EXPORTER'S POINT OF VIEW AND ASSUMING THAT DOMESTIC PRICE LEVELS REFLECT HIS COSTS, THE HIGHER RATE OF INFLATION IN INDONESIA WOULD MEAN THAT HE EXPERIENCES DOMESTIC COST INCREASES NOT COMPENSATED BY CHANGES IN HIS ACTUAL PROCEEDS FROM EXPORTS AND THAT CONSEQUENTLY HE SUFFERS A COST-PRICE SQUEEZE, REDUCING HIS PROFIT INCENTIVE TO EXPORT.

CONFIDENTIAL

NNN

CONFIDENTIAL

PAGE 01 JAKART 02221 03 OF 04 180711Z
ACTION EA-12

INFO OCT-01 ISO-00 ONY-00 /013 W
-----089111 180715Z /23
R 171010Z FEB 78
FM AMEMBASSY JAKARTA
TO SECSTATE WASHDC 6913

C O N F I D E N T I A L SECTION 3 OF 4 JAKARTA 2221

STADIS FOR EA ONLY//////////

14. THERE ARE, OF COURSE, A NUMBER OF DEFICIENCIES IN THE PPP APPROACH, BUT NOTWITHSTANDING THESE SHORTCOMINGS, WE BELIEVE IT IS USEFUL AS ONE ROUGH MEASURE OF WHETHER

THE RUPIAH IS OVER- OR UNDERVALUED AT LEAST INsofar AS INDONESIA'S TRADITIONAL NON-EXTRACTIVE EXPORTS ARE CONCERNED. IN THE ANALYSIS BELOW, WE MEASURE THE CHANGE IN THE CONSUMER PRICE INDEX FOR INDONESIA DURING THE PERIOD 1971 THROUGH SEPTEMBER 1977 AS COMPARED WITH CHANGES IN CONSUMER PRICE INDICES FOR INDONESIA'S MAJOR TRADING PARTNERS FOR THE SAME PERIOD. APPLYING THE STANDARD PPP FORMULA AND USING FIGURES FROM IFS, THE FOLLOWING RATIOS ARE OBTAINED: U.S. (2.11); SINGAPORE (1.92); JAPAN (1.64); NETHERLANDS (1.93); AND FRG (2.3). THESE RATIOS DEMONSTRATE THAT PRICES AND PRESUMABLY PRODUCTION COSTS FOR NON-EXTRACTIVE EXPORTS AS WELL, HAVE INCREASED MUCH MORE RAPIDLY IN INDONESIA THAN IN THE ECONOMIES OF ITS MAJOR TRADING PARTNERS' PRICES.

15. BY APPLYING THESE PARITY PRICE RATIOS AGAINST THE 1971 EFFECTIVE EXPORT RATE DETERMINED EARLIER, THE PARITY EXPORT RATE FOR 1977 CAN BE DETERMINED, I.E., THE EFFECTIVE EXPORT RATE THAT WOULD COMPENSATE INDONESIAN EXPORTERS FOR A FASTER RATE OF DOMESTIC INFLATION THAN OCCURRED ELSEWHERE.

(A) (B) (AXB)

CONFIDENTIAL

CONFIDENTIAL

PAGE 02 JAKART 02221 03 OF 04 180711Z

| | EFFECTIVE EXPORT RATE 1971 | PP RATIO | PARITY RATE 9/77 | EFFECTIVE EXPORT RATE 9/77 |
|-------------|-------------------------------|----------|---------------------|-------------------------------|
| U.S. | 382 | 2.11 | 806 | 391 |
| SINGAPORE | 127 | 1.92 | 243 | 160 |
| JAPAN | 113 | 1.64 | 185 | 147 |
| NETHERLANDS | 111 | 1.93 | 214 | 159 |
| FRG | 112 | 2.3 | 258 | 170 |

16. THE "PARITY LOSS" SUSTAINED BY INDONESIAN EXPORTERS IS A MEASURE OF THE EXTENT TO WHICH HIGHER DOMESTIC COSTS ARE NOT OFFSET BY INCREASED EXPORT PROCEEDS DERIVED FROM A MORE FAVORABLE EXCHANGE RATE. FOR EXAMPLE, AN INDONESIAN EXPORTER SELLING TO THE FRG IN SEPTEMBER 1977 WOULD, AFTER TAX, SELL EACH MARK EARNED FOR 170 RUPIAH, 52 PERCENT MORE RUPIAH PER MARK THAN HE RECEIVED IN 1971. HOWEVER, AFTER ALLOWING FOR THE INFLATION RATE DIFFERENTIAL BETWEEN THE TWO COUNTRIES, HE WOULD HAVE TO RECEIVE 258 RUPIAH PER MARK IN 1977 IN ORDER FOR HIS EXPORT PROCEEDS TO HAVE THE SAME PURCHASING POWER IN INDONESIA AS THEY HAD IN 1971. IN OTHER WORDS, IN 1977 HE RECEIVES ONLY 66 PERCENT OF 1971 PARITY (170 DIVIDED BY 258) AND HE THEREFORE SUSTAINS A "PARITY LOSS" OF 34 PERCENT. THE PARITY LOSSES OF INDONESIA WITH THE OTHER FOUR COUNTRIES ARE: U.S. 51 PERCENT; SINGAPORE 34 PERCENT; JAPAN 21 PERCENT; AND NETHERLANDS

26 PERCENT. ON A TRADE-WEIGHTED BASIS, THE AVERAGE PARITY LOSS IS 37 PERCENT. EXPRESSED ANOTHER WAY, THE RELATIVE PURCHASING POWER OF AN INDONESIAN EXPORTER'S PROCEEDS HAS DECLINED ON AVERAGE BY 37 PERCENT BETWEEN 1971 AND SEPTEMBER 1977 EVEN AFTER ALLOWING FOR FAVORABLE EXCHANGE RATE CHANGES AND EXPORT TAX REDUCTIONS.

CONFIDENTIAL

CONFIDENTIAL

PAGE 03 JAKART 02221 03 OF 04 180711Z

17 PARITY CALCULATIONS FOR INDONESIA'S REGIONAL COMPETITORS, THAILAND, MALAYSIA AND THE PHILIPPINES, SHOW THAT THEY HAVE LOST SOME GROUND BUT ON BALANCE HAVE SUFFERED FAR LESS COST DISCRIMINATION OWING TO UNEQUILIBRATED EXCHANGE CHANGES. THE FOLLOWING TABLE SHOWS, FOR THE SAME PERIOD AS ABOVE, PARITY POSITIONS OF THOSE THREE COUNTRIES VIS-A-VIS THE UNITED STATES. THEIR PUBLISHED EXCHANGE RATE IS ASSUMED TO BE THEIR EFFECTIVE EXPORT RATE, I.E., NO EXPORT TAXES. THE FIGURES AGAIN ARE FROM INTERNATIONAL FINANCIAL STATISTICS.

| | EXCHANGE RATE | PP RATIO | PARITY EXPORT RATE | EXCHANGE RATE |
|-------------|------------------|----------|-----------------------|------------------|
| COUNTRY | 1971 | 1977 | 1971 | 1977 |
| MALAYSIA | 2.89 | .99 | 2.86 | 2.46 |
| PHILIPPINES | 6.44 | 1.36 | 8.76 | 7.40 |
| THAILAND | 20.928 | 1.14 | 23.86 | 20.40 |

THE PARITY LOSS IN PERCENTAGE TERMS IS AS FOLLOWS:

MALAYSIA (14); PHILIPPINES (16); AND THAILAND (15).

THESE MODEST LOSSES COMPARED WITH INDONESIA'S 37 PERCENT LOSS OVERALL HELPS TO EXPLAIN WHY INDONESIA'S NON-EXTRACTIVE EXPORTS HAVE STAGNATED WHILE THOSE OF HER NEIGHBORS HAVE CONTINUED TO GROW.

18. EXPORT PRICES. INDONESIA IS FORTUNATE IN THAT DURING THE PERIOD REVIEWED, WORLD MARKET PRICES FOR MANY OF ITS NON-EXTRACTIVE EXPORT HAVE RISEN SIGNIFICANTLY. RISING PRICES HAVE HELPED TO CONCEAL THE VERY SLOW GROWTH IN EXPORT VOLUMES. THEY HAVE ALSO SERVED, TO A CERTAIN EXTENT, AS AN EXOGENOUS CORRECTIVE FOR THE PARITY LOSS SUSTAINED BY EXPORTERS.

19. LATEST COMMODITY PRICE FIGURES TAKEN FROM INTERNATIONAL FINANCIAL STATISTICS (DECEMBER 1977) SHOW THAT THE UNWEIGHTED AVERAGE PRICE FOR INDONESIA'S MAIN NON-EXTRACTIVE EXPORT INCREASED 130 PERCENT FROM 1971

CONFIDENTIAL

CONFIDENTIAL

PAGE 04 JAKART 02221 03 OF 04 180711Z

TO THE PRESENT. IF COFFEE, WHICH INCREASED BY 285 PERCENT AND THEREFORE DISTORTS THE AVERAGE, IS DELETED FROM THE COMPUTATION, THE UNWEIGHTED AVERAGE PRICE INCREASE IS 111 PERCENT, WELL ABOVE THE WORLD RATE OF INFLATION. DURING THIS SAME PERIOD, HOWEVER, DOMESTIC PRICES IN INDONESIA ROSE BY 233 PERCENT SO THAT EVEN ALLOWING FOR THE 23 PERCENT AVERAGE IMPROVEMENT IN THE EFFECTIVE EXPORT RATE, EXPORTERS' GAINS FROM WORLD PRICE INCREASES (PLUS 111) AND A DEPRECIATING CURRENCY (PLUS 23) HAVE LAGGED FAR BEHIND DOMESTIC COST INCREASES (MINUS 223).

CONFIDENTIAL

NNN

CONFIDENTIAL

PAGE 01 JAKART 02221 04 OF 04 180720Z
ACTION EA-12

INFO OCT-01 ISO-00 SS-15 ONY-00 /028 W
-----089333 180725Z /11

R 171010Z FEB 78
FM AMEMBASSY JAKARTA
TO SECSTATE WASHDC 6914

C O N F I D E N T I A L SECTION 4 OF 4 JAKARTA 2221

STADIS

FOR EA ONLY

20. WE WOULD CONCLUDE FROM THE FOREGOING THAT, INSOFAR AS INDONESIAN EXPORTERS OF NON-EXTRACTIVE COMMODITIES ARE CONCERNED, THEY ARE RELATIVELY LESS WELL OFF IN 1977 THAN THEY WERE IN 1971 BECAUSE THE RATE OF INFLATION HAS BEEN SIGNIFICANTLY HIGHER IN INDONESIA THAN IN AND AMONG EITHER ITS TRADING PARTNERS OR ITS REGIONAL TRADING COMPETITORS. THIS HIGHER RATE OF INFLATION HAS NOT BEEN FULLY OFFSET BY EVEN THE COMBINED EFFECT OF REDUCED EXPORT TAXES, A DEPRECIATED CURRENCY AND MORE FAVORABLE WORLD MARKET PRICES.

21. WE WOULD LIKE TO STRESS HERE THAT THE FOREGOING ANALYSIS OF THE VALUE OF THE RUPIAH APPLIES PRIMARILY TO NON-EXTRACTIVE EXPORTS (AND NOT INCLUDING TIMBER) AND THAT AT THE PRESENT TIME THESE EXPORTS CONSTITUTE ONLY A RELATIVELY SMALL PART (14 PERCENT) OF INDONESIA'S TOTAL EXPORT TRADE. AS WE NOTED AT THE OUTSET,

INDONESIA'S TRADE ACCOUNT IS DOMINATED BY EXTRACTIVE EXPORTS. WITH THOSE EXPORTS, FOR THE PRESENT AT LEAST, FAIRLY BOUYANT AND WITH FOREIGN EXCHANGE RESERVES GROWING, A CASE CANNOT BE MADE ON BALANCE OF PAYMENTS GROUNDS FOR A CHANGE IN THE GOI'S EXCHANGE RATE POLICY. THE DOMESTIC INFLATIONARY TENDENCIES OF THIS ECONOMY
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 JAKART 02221 04 OF 04 180720Z

ALSO ARGUES FOR CAUTION IN ALTERING EXCHANGE RATE POLICY. OTHER MEASURES TO REDUCE DOMESTIC COSTS AND INCREASE EFFICIENCY/PRODUCTIVITY SHOULD ACCOMPANY A CHANGE IN EXCHANGE RATE POLICY IN ORDER TO MAKE NON-EXTRACTIVE EXPORTS MORE COMPETITIVE IN WORLD MARKETS.

22. NONETHELESS, THE PHENOMENON OF DECLINING ACTIVITY IN THE MORE TRADITIONAL, LABOR-INTENSIVE, NON-EXTRACTIVE EXPORT SECTOR COEXISTING WITH RISING FOREIGN EXCHANGE RESERVES AND A STRONG CURRENCY ILLUSTRATES THE FRUSTRATING DUALISM PRESENT IN THE INDONESIAN ECONOMY. IN A SUBSEQUENT PAPER WE WILL EXAMINE SOME OF THE DOMESTIC EFFECTS OF THE PRESENT VALUE OF THE RUPISH.
MASTERS

CONFIDENTIAL

NNN

Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FOREIGN EXCHANGE RATES
Control Number: n/a
Copy: SINGLE
Draft Date: 17 feb 1978
Decaption Date: 20 Mar 2014
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978JAKART02221
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780075-0575
Format: TEL
From: JAKARTA
Handling Restrictions:
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780242/aaaabjpx.tel
Line Count: 520
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: cdf9a2d4-c288-dd11-92da-001cc4696bcc
Office: ACTION EA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: ONLY, STADIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 10
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: ONLY, STADIS
Reference: 78 STATE 24207
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 02 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3564136
Secure: OPEN
Status: NATIVE
Subject: EXCHANGE RATE AND DEVELOPMENT
TAGS: EFIN, ID
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/cdf9a2d4-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014